

THE ROLE OF FOREIGN CAPITAL AND MULTINATIONAL COMPANIES AND THEIR EFFECT ON ECONOMY IN HUNGARY

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ABSTRACT

Presence of the international companies, alien properties, and the foreign capital in Hungary is under a wide social debate. It is the foreign capital which established Hungary's long-range development and this capital will significantly influence it in the future, too. After the political transformation reintegration into the world economy, establishment of market economy and modernization of the economic structure realized by foreign investments implied an outstanding potential for further development.

However, by today the capital drawing ability of Eastern Europe, and Hungary has declined as a result of which adaption to the new situation, reversal of this trend, our ability to keep the capital, and giving the chance to companies in home property all are of stressed importance.

1. INTRODUCTION

In the post-socialist countries, among them in Hungary, too, the first foreign investors appeared on the scene at the end of the 80s. Closing up the Eastern block of Europe could be started by accepting the foreign capital, which is to say by the expansion of multinational companies. This process was considerably supported by globalization, on one hand, and economic policy of the potential capital receiving countries, on the other hand. This latter one can either significantly help or, within certain frames, can restrain the effects of transformation in world economy. In the following chapters I am aiming to examine and analyse the characteristic features of the foreign capital inflow coming to Hungary.

2. INFLUX OF FOREIGN FUNCTIONING CAPITAL FROM THE POLITICAL TRANSFORMATION TO THE END OF THE 90S

In our country, before the political transformation the term internationalization was restricted to the specific relationship with the CMEA-countries and the role of foreign investment was minimal.

However, the political transformation meant a real milestone since the earlier economic relations changed in their quality and almost unlimited opportunities were opened for the international companies to establish companies of production and service in Hungary¹.

¹ Lásd: SIMAI MIHÁLY: *A világgazdaság a XXI. század forгатagában* Akadémiai Kiadó Zrt. Budapest 2007. (a továbbiakban SIMAI 2007.) 317-325.

If we examine the 90s, it can be stated that German companies brought the most capital into our country, due to their significant participation in privatization of the energetic sector. Even the United States took its part from the greenfield investments. (General Electric, General Motors, Ford, Guardian Glass).

Besides them, Austrian, French, Dutch and Italian investors appeared on the scene, too.

At first, the foreign capital was typically concentrated on Budapest and its environs, and on the northern Transdanubian area. However, areas close to motorways, like northeast Hungary (TVK, Borsodchem, Alkaloida) and Gödöllő, Kecskemét² in the Eastern part of the country took their share, too.

Direct capital import is an important factor of integration into the developed market economies which greatly affects GDP, as well, since modern company management appears too, besides translation of the developed techniques and capital import. Multinational companies are efficient to get the external markets due to their existing relations. All these factors have an important part in that the country on the way of transition is able to achieve a relatively high sustainable pace of development even in the time span of one-two decades.

By 1997 or by the beginning of the increase the stock of functioning capital flowing into the Hungarian economy was 15,5 billion USD which calculating on the exchange rate of dollar in '97 meant 42% of the GDP. By this time Hungary had lost its leading position among the former Socialist countries, regarding the absolute extent of the direct capital import stock, but it still was in the leading position considering the total direct import per capita and direct capital import in proportion with GDP.

In the beginning more than a half of the capital import had been directed to the processing industry, but by 1997 this proportion had changed since it became the service sector to take away the bigger import capital, by this time its proportion was 59%.

It significantly influenced the pace of growth since export dynamics was considerably more intensive in processing industry than in the tertial sector. Today technical development is significant in the tertial sector, too, so even this field can influence long-range development. Also, it is worth considering that the pace of development is always bigger in a country on the way of transition than in the leading economy³.

3. INFLUX OF FOREIGN FUNCTIONING CAPITAL AFTER THE TURN OF THE MILLENNIUM

If I examine the process of the influx of functioning capital at a longer range, between 1990 and 2008, it can be stated that the stock of functioning foreign capital exceeds *57 billion EUR* in our country.

The annual distribution of direct foreign capital investments between 2000 and 2008 is shown by the following diagram from which it can be read that the year 2007 was outstanding with its sum of 58.457 EUR. In 2008 decrease in capital stock was clearly due to the foreign

² Lásd: <http://www.hhrf.org/korunk/9811/11k27.htm>

³ Lásd: ERDŐS TIBOR: *Fenntartható gazdasági növekedés* Akadémiai Kiadó, Budapest 2003. 328-345.

disinvestment. The diagram shows that the growth is continuous up to 2007, the capital inflow increased by more than its double in the examined period.

The high proportion of German investment typical to the 90s stayed in Hungary in 2008, too, since this country accepted 23,7% from the total foreign capital investments. Examining the period between 2000 and 2008, it can be stated that the bigger part of capital investments comes from Europe, as this proportion was between 79-84% during the mentioned years.

The following diagram contains division (%) of the direct foreign capital investments coming to Hungary in 2008.

Stock of direct foreign capital investments in Hungary in million €

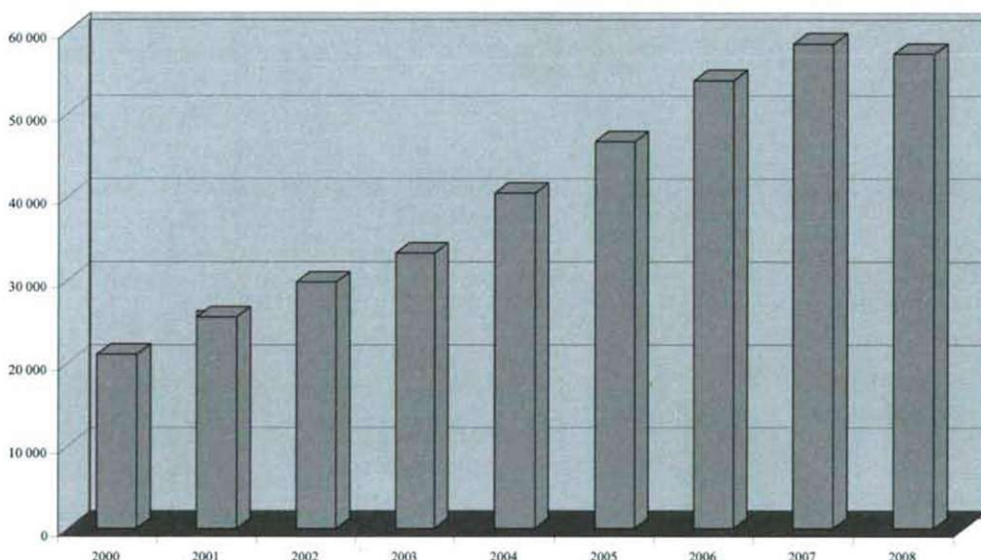


Figura 1: Changes in the stock of direct foreign capital investments from 2000 to 2008, my own data process – Source: MNB⁴

⁴http://www.mnb.hu/Statisztika/statisztikai-adatok-informaciok/adatok-idosorok/vii-kulkereskedelem/mnbhu_kozetlen_tokebef MNB A nem rezidensek magyarországi közvetlen tőkebefektetés (részvény, egyéb részesedés és újrabefektetett jövedelmek) állományának országokénti megoszlása

Direct capital investments in Hungary according to countries in 2008

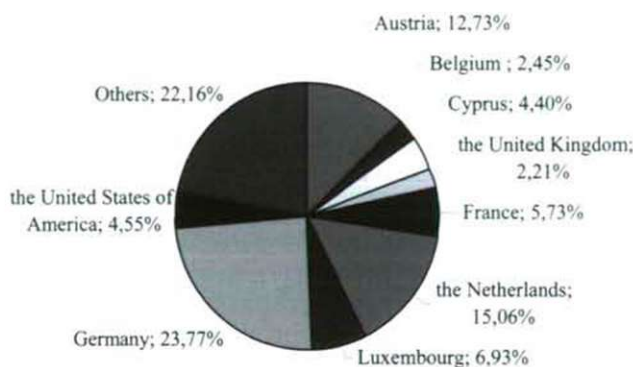


Diagram 2. Division of the direct foreign capital investments in 2008 according to the countries of origin- my own data process- Source: MNB⁵

Division of direct capital investments according to branches

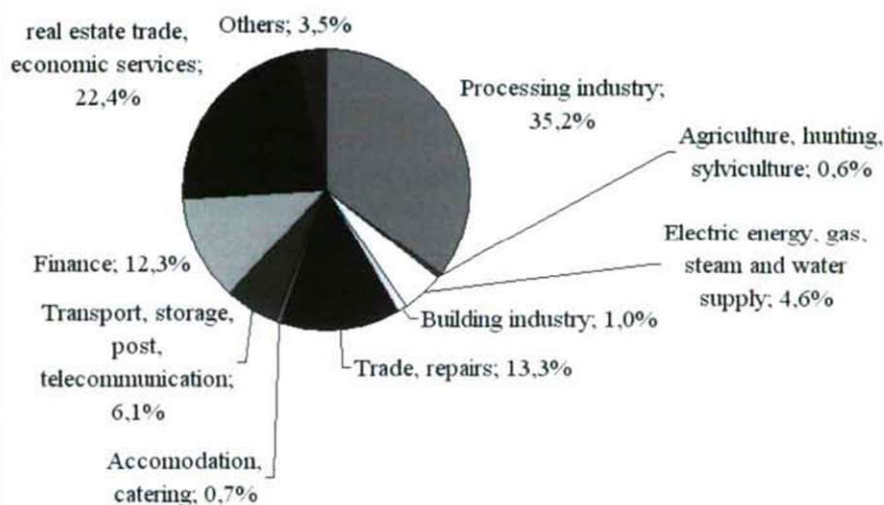


Diagram 3 Division of direct foreign capital investments in 2008 according to sectors – my own data process – Source: MNB

⁵http://www.mnb.hu/Statisztika/statisztikai-adatok-informaciok/adatok-idosorok/vii-kulkereskedelem/mnbhu_kozetlen_tokebef MNB: A nem rezidensek magyarországi közvetlen tőkebefektetés (részvény, egyéb részesedés és újrabefektetett jövedelmek) állományának ágazatonkénti megoszlása

It can be seen in Diagram 3 that besides the German capital, the Dutch (15,06%), the Austrian (12,73%), the Luxembourger (6,93%), the French (5,73%) and the American (4,55%) proportions are remarkable, too.

The tendency which was experienced at the turn of the millennium, too, remained in 2008 according to which more than a half of the inflowing foreign capital was accepted by service sectors.

It can be seen from the above diagram that 54,8% of the foreign capital was directed to the service sectors.⁶

4. EFFECTS OF THE PRESENCE OF MULTINATIONAL COMPANIES ON THE HUNGARIAN ECONOMY

In the 21st century multinational companies, banks, multilateral organizations and the European Union have an important role regarding internationalization.

In the book of Simai Mihály, published in 2007, we can read the following:

„Considering the importance of transnational countries and regarding *„the transnationality index”* calculated by the researchers of the UN Trade and Development Conference Hungary is in the seventh position among both the developed countries and within the borders of the EU, while *in the twelfth place* out of eighty countries if we consider the *whole world*. The basis of the transnationality index is the extent of capital property of international companies, the proportion of new value in BNT produced by them, and proportion of their employees in the whole number of workers.”⁷

Expansion of the multinational companies in Hungary is under continuous discussion.

Let's examine the effects more closely!

In the process of *reintegration of the Hungarian economy into the world economy* expansion of the foreign sector has become the most important factor since 90s. The internal effect of this process is also remarkable.

Companies in foreign possession have significantly *transformed the structure of the Hungarian industry*, export and import, proportion and direction of technical development and the quality of service sector.

We should not forget that the international companies considerably influence the *income of both the state and population and employment*.

It is evident that due to the above mentioned process *we depend on the effects of the processes in the international market* (let they be positive or negative), though it helps the Hungarian economy grow, we have to take the significant oscillations, and the possible consequences of the speculative operations into consideration.⁸

⁶ http://www.mnb.hu/Engine.aspx?page=mnbhu_statistikai_idosorok&ContentID=11130
MNB A nem rezidensek magyarországi közvetlen tőkebefektetés (részvény, egyéb részesedés és újrabefektetett jövedelmek) állományának ágazatonkénti megoszlása

⁷ see: SIMAI 2007. 395.

⁸ see: SIMAI 2007. 384-402.

The foreign greenfield industrial investments establish new workplaces, these companies produce mainly to export. Their most important representatives are Audi, Opel, Suzuki, Ford, Philips, Nokia, Sony etc.

There is a bigger professional and social criticism in connection with privatization of the energetic sector and financial institutions carried out by foreign investors. The first one can be explained with *rise in prices*, while the second one with the fact that Hungarian companies have *difficulties in getting bank loans* and that the *foreign control is increased* this way.

Multinational companies, hypermarket of food industry and trade attract customers from small and medium-sized shops in *home ownership* the process of which clearly results in *their impossibility of performance*.

In case of multinational companies *decisions* on development, the profit, investments are made in the *central office of the parent company*, so we can be winners and losers of these decisions. We can be winners if we can fulfil the function of regional „sub-centre” or with further home investments, but at the same time, sister companies in other countries can take away these possibilities from us, which means further risk.

Before the appearance of the foreign capital the home state companies lacked the capital which hindered competitive technical-technological investments. It is obvious that the international companies solved this problem with their own capital force or their credit of lower expenses, so the owners *could assure the financial and technical source* necessary to reorganize the given company.

According to home experiences, the multinational companies carried out a serious *reorganization* in the privatized companies. It involved sales and marketing departments, networks of sales from which they demanded a more customer-oriented operation more suitable for the requirements of market economy. Basically, two strategies were realized, the first one is transplantation of standards typical to the given company group and the second one is marketing and sales strategy appropriate for the local customs of consumption.

As for finance, it was typical that a *strong control* was executed by the person delegated by the owner which was accompanied with the deeper knowledge about the company and assessment of reserves. Besides, *modernization of financial information system* and *new structure of administrative systems* became typical.

Among expenses of several international companies we can find know-how, licences, fees of consulting, fees of management services by means of which, among others, even *tax optimization* can be realized within the company group.

The range of products in case of the newly purchased home companies transformed in order to fit into the strategy of the company group. Consequently, *transformation, enlargement and utilization of capacity* resulted in a more efficient operation, perhaps thus *outplacing production of small series*.

By *profile cleaning* certain service activities (maintenance, cleaning, catering, security service) were left out and they were ordered from external contractors (outsourcing).

In the field of *research-development* capacity is submitted to the interests of the entire company group which also means *reorganization*, reduction or even building a new research base. The so-called regional divisions of research and development are getting more and more widespread.

Multinational companies generally practise a centralized policy of purchase price reduction of which, due to the order of great volume, results in a significant cost advantage. As a result, unfortunately, *the local suppliers of background industry*, which serve only the home company having a limited capacity, *are replaced* and the proportion of import will increase in this field. Thus, for example, the former suppliers of Lehel Fridge Factory, Tungsram and

Telephone Factory suffered a serious loss in market. Besides, *while determining the suppliers quality, price and reliability in transport* are of determinant importance, thus only competitive companies can fulfil these requirements. However, these latter ones might serve sister companies in other countries, too.

In management level the control of the parent company is strong, home managers have smaller independence than in case of companies in Hungarian possession.

International companies employ *young, more qualified labour force* who can adapt the new knowledge in a more flexible way and can suffer more burden than their older colleagues. Therefore companies in foreign possession tend to *pay more* for their employees, though *productivity of these employees* compensates the higher labour force expenses.

In Hungary *the knowledge transfer* realized by the multinational companies formed a human resource in the Hungarian labour market which is really creative, productive and competitive. Besides, the modern knowledge of management has become widespread. Knowledge of a foreign language is indispensable in this environment, and knowledge of organization has become well-known, too.

Regarding the balance of foreign trade, it can be observed that *at the beginning of the foreign capital investments* it declines, since suppliers of the parent company take more part, later it can be compensated by the export of home suppliers. In case of industrial technologies investments are realized mainly from import, so developments of this kind worsen the balance. However, it can be counterpoised by the export residue due to them. In case of foreign capital investments directed to obtain the home market, import can be emphasized in the fields of car-assembly, production of telephone centre and packaging technology.

The current account improves due to the influx of foreign capital (investments, developments), however, it declines due to the profit transfer – namely profit allocation in foreign currency. Besides paying dividend, other *techniques of income reduction* are used, basically for tax optimization.

In several sectors – e.g. building industry, trade, food industry and sectors of energy and public utilities- *concentration* of great size is realized by the foreign capital which was induced by the bigger share in market and *optimal factory size*.

Besides, *increase in competition* can be observed in some branches, since competitive spirit has become implanted in Hungary, too, which on one hand, makes the home companies competitive, and on the other hand, competition is in the interest of customers, as well, for example, in the field of financial sector.

Foreign managers and their families in Hungary live lives of consumers of significant income. To satisfy their needs *the international characteristics has entered our culture* which is expressed in cultural programmes, expansion of the international media and special services.

5. FUTURE OF MULTINATIONAL COMPANIES IN OUR COUNTRY

Thinking of the functioning capital I have the picture „there are always more round pegs than round holes” in my mind. In the 90s our country could invite foreign capital with the *cheap labour force* and *government subsidies*, which is typical to periphery countries. However, after the period of privatization dynamics of FDI-inflow seems to decrease so we have to *change strategy regarding the other countries functioning in periphery*.

Withdrawals can affect the home economy very seriously, we have to think of the example of IBM or firms which did not and do not intend to establish any relations with the Hungarian businesses, they just have products coming from foreign suppliers assembled which they at once transport to other foreign markets. Firms without roots like these generally rent both the large workshop and a significant part of the labour force, so within few weeks they can easily change premises.

We have to give chance to the activities which produce higher added value and which prefer home suppliers and qualified labour force, mainly research and development should have key importance.

It might protect us from withdrawals, though nothing can be sure in this case, since *profit-orientation* is the most important thing for strategic decision-makers of international companies. Service and logistic centres could mean a real breakout for our country, though today it implies a huge competition.

Besides rootless international companies, we have to mention the other pole, as well, because there are companies which carry out R+D activity in our country, like, for example, General Electric, Sanofi Chinoïn, Nokia, Siemens, Audi, Knorr-Bremse, Flextronics, Michelin, Unilever etc.⁹

In case of international companies in high-tech industry, while making decision on their investments in Hungary *know-how in the industry* was one of the influencing factors. It is an even bigger advance that in their Hungarian premises centres of development and testing were established, going beyond the category of place of production. An excellent example for it the subsidiary company of ZF in Eger chose the University of Miskolc and the Technical University of Budapest as its partners. In this case the firm directs the researches and the research results can be utilized at once in the field of technology development which reacts to the export ability of our country and to the increase in economy. I can hardly image a *better win-win relation*.¹⁰

6. SUMMARY

During the examination of this subject I could conclude that it is absolutely necessary to improve the capital attracting ability of Hungary from the aspect of her future development.

For this I thought important to underline the following things:

- *Activities of higher added value* should have more attention.
- *Switch over to services* can create a new situation since it can change the way of thinking about the premises. Thus higher qualifications and knowledge of language can play more important roles.
- Influx of the foreign capital into the food processing industry can be realized with success only when *the necessary service background is established*, too.
- *Infrastructure of traffic and telecommunication* should be developed even more.
- *It is necessary to become specialized in new fields, in activities which need labour force of high qualification*, for example we can aim at location of service, financial and administrative centres within the company groups to our country.

⁹ See: IVICZ MIHÁLY- KATONA KLÁRA – SCHLETT ANDRÁS: Vonzó-e Magyarország a működő tőke számára

In: BOTOS KATALIN: *Pénzügyek a globalizációban* JATEPress Szeged 2004. 58-67.

¹⁰ See: http://www.gtm.hu/cikk.php?cikk_id=735

- It is necessary to increase *the efficiency of subventions*. Besides, it is advisable to pay attention to regional development if we want prevent companies from leaving our country after that the subventions have been finished.
- Corruption has to be forced back.
- We should pay more attention to the soft factors of capital attraction. It is necessary to consider what qualitative and quantitative conditions a given area has for example, in the fields of *life quality, education and culture*.

As a result, Hungary can not only obtain capital import of long-range but also continuous knowledge transfer.

Besides, it is necessary to minimize the risk coming from our international dependence.

Closing up home companies means a huge challenge but with a strategically well-planned, well-organized system of subsidies these companies can become real, serious *suppliers* or even *competitors* of international companies, or *significant performers of home market* not only in Hungarian but in *international aspect, too*.

The stressed question of today's Hungarian economy is how we can utilize *the human capital* for the interest of companies both in foreign and home possession, so that *the employee, the management* can be satisfied both professionally and financially, so that *the budget* can be satisfied by means of taxes, and this way indirectly even *the Hungarian society* can be satisfied. I am aware of that not every international company has left stories of success in Hungary, that is why it is the government's responsibility to minimize this risk by means of that, for example, foreign companies should be motivated to stay and to use Hungarian suppliers. I honestly imagine a future where in *the public conscious* the term multinational company does not evoke negative feelings but rather *confidence, chances for development, an example to follow, development of the home economy and cultural diversity*.

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